SENATE TAXATION
EXHIBIT NO. 5
DATE 3.18.11
HB 333

Montana Department of Revenue

Dan Bucks
Director

Brian Schweitzer
Governor

MEMORANDUM

To: Senate Taxation Committee

From: Alan Peura, Deputy Director

Date: March 18, 2011

Subject: Committee Questions on HB333 (Committee Hearing on March 15th)

At the hearing on the above referenced bill, committee members asked me to provide additional history and justification for the mass appraisal industry standard that recommends the use of foreclosure sales price information for property valuation modeling when the proportion of distressed sales to total sales in a specific market model area reaches 20%. This memo is intended to address this question.

Before moving to the response, I would like to clarify a potential misperception that I may have left from my testimony at the hearing when I discussed foreclosure data from Flathead County. That data point indicates that the current foreclosure rate in Flathead County is 28%; specifically this means that of the **actual real estate sales** in Flathead County, recent data indicates that 28% of those actual sales were foreclosure sales. I want to be sure that I did not leave the impression that of all mortgages in Flathead County, 28% are in foreclosure, when **it is 28% of those actual sales only**.

According to the Federal reserve bank of New York, currently 4.3% of all mortgages in Flathead County are 90 days delinquent or in foreclosure. In Lake County, it is 3.8%.

As to the justification and history of the 20% mass appraisal industry standard benchmark, that figure is related both to concerns about having a sufficient sample size for valuation modeling as well as that figure being seen as the tipping point at which direct inclusion of foreclosure sales prices are required to derive values that are reflective of the actual market.

The following are statements on this question that we received from both Richard Almy and Robert Gloudemans, partners in the firm Almy, Gloudemans, Jacobs & Denne. This is the consultant firm hired by the Department of Revenue, under HB658, to complete the assessment/sales ratio study of the department's 2009 appraisal values. Mr. Gloudemans serves on the Technical Standards Committee of the IAAO, which promulgated this 20% foreclosure standard benchmark.

According to Richard Almy:

"Before the recent housing market crisis, forced sales and sales involving financial institutions (especially those in which the mortgage holder was the buyer) were regarded as unusable in ratio studies (or in valuation modeling). The prices could not be presumed to be indicative of market values, because the sales failed the arm's-length, open-market tests implicit in the definition of market value [and in Montana statute]. Normally such sales could be disregarded, because sufficient, representative sales remained for analysis. But when the foreclosure crisis broke, two problems with the traditional policy emerged. First, disregarding foreclosure sales could result in insufficient sales for analysis. Second and more important, a significant number of foreclosed properties on the market have a depressing effect on market prices generally that could not be ignored. That is, sales of foreclosed properties should be included in the mix."

According to Robert Gloudemans:

"The TAAO Technical Standards Committee (of which I am a member) settled on the 20% figure. Although there was some good discussion, all members of the Committee felt comfortable with the figure. Some jurisdictions consider them by giving them partial weight in one way or another; others use them like any other sale.

Therefore, the 20% benchmark standard for mass appraisal is driven by the statistical need to ensure that an adequate sample size is available for valuation modeling so that once 20% or more of the real estate sales are distressed, and thus do not meet the arms-length criteria, there is the statistical need to expand the available data pool. In addition, the 20% benchmark is related to the economic analysis that at that proportion of total sales in the market, foreclosure sale prices should be included directly into the valuation modeling sample.